

Review of Compliance with the Prompt Payment Act
Report No. 05-06, June 15, 2005

INTRODUCTION

This report presents the results of the Office of Inspector General's (OIG) review of compliance with the Prompt Payment Act at the Railroad Retirement Board (RRB).

Background

The RRB is an independent agency in the executive branch of the Federal government that administers the health and welfare provisions of the Railroad Retirement Act (RRA), funded primarily by payroll taxes and transfers from the trust funds of the Social Security system. During fiscal year (FY) 2004, the Railroad Retirement program paid over \$20 million in administrative expenses, excluding salary and benefits paid to its employees.

In general, the Prompt Payment Act requires that interest be paid when payments to a commercial vendor are issued after the payment due date. Under the Act, payment is due 30 days after a proper invoice is received or goods/services are accepted. Interest on late payments should be calculated from the day after the payment due date through the payment date at the interest rate in effect on the day after the payment due date.

The Prompt Payment Act also imposes restrictions on the early payment of vendor invoices without management approval. A payment is considered early if it is issued more than seven days prior to the payment due date. Payments under \$2,500 and payments to certain vendors are exempt from these restrictions.

The Bureau of Fiscal Operations (BFO) is responsible for processing invoices for payment. The Federal Financial System (FFS), the mainframe application that supports general ledger accounting, includes an integrated purchasing subsystem that supports procurement of goods and services from requisition to payment. After an invoice has been approved for payment, a payment voucher is entered into FFS. FFS uses milestone dates to make timeliness determinations, identify payments on which interest may be payable and compute the amount of interest due. The key FFS milestone dates are "Invoice Date," "Log Date" (or Invoice Receipt Date), "Acceptance Date," "Payment Voucher Date", "Schedule Date," and "Check Date."

Regulations governing Prompt Payment Act compliance also require agencies to perform annual quality assurance reviews to assess their performance. The RRB's annual compliance assessment is performed by BFO's Financial Compliance Officer.

This review was undertaken to support the OIG's audit of the RRB's FY 2005 financial statements, which is required by the Accountability of Tax Dollars Act of 2002. The Office of Management and Budget's Bulletin 01-02, Audit Requirements for Federal Financial Statements, requires that certain provisions of the Prompt Payment Act be tested as part of every audit of a Federal agency's financial statements.

Objective

The objective of this audit was to assess the RRB's compliance with the Prompt Payment Act.

Scope

The scope of this audit was payments to vendors and contractors made during the first quarter of FY 2005. We expanded the scope of our evaluation to include the 27 month period October 2002 through December 2004 in order to more fully estimate the impact of control weaknesses.

Methodology

To accomplish our objective, we:

1. identified management and system controls over Prompt Payment Act compliance;
2. used statistical and non-statistical sampling methods to assess the effectiveness of controls and evaluate the accuracy of transaction processing;
3. interviewed responsible staff and management; and
4. evaluated the effectiveness of the agency's Prompt Payment Act quality assurance process.

We considered the results of the control assessments and transaction tests, supplemented by data analysis, in forming our overall assessment concerning compliance. The details of our sampling methodologies are presented in appendices I and II to this report.

Our work was performed in accordance with generally accepted government auditing standards as applicable to the objective. We performed audit fieldwork at RRB headquarters in Chicago, Illinois during January through April 2005.

RESULTS OF REVIEW

The RRB has not fully complied with the Prompt Payment Act. The systems and procedures that the agency uses to implement the Act have not been effective in ensuring that interest is paid to vendors in accordance with the requirements. The RRB does not identify all invoices on which interest should be paid and does not pay the correct amount of interest when a late payment is recognized. In addition, controls are not adequate to ensure that required restrictions on early payment have been properly implemented.

Many of the problems identified by our audit had been reported repeatedly in the agency's internal assessments of Prompt Payment Act compliance; however, that process was not adequate to disclose the overall impact of errors or effect changes in agency performance.

Changes Are Needed to Ensure Compliance with Late Payment Provisions

The RRB does not pay interest in full compliance with the Prompt Payment Act because its policies, procedures and controls do not ensure that the agency identifies all invoices on which interest should be paid or that it pays the correct amount of interest.

As a result of weaknesses in system and management controls, the RRB did not identify all late payments or pay all interest due under the Prompt Payment Act. The RRB paid \$4,033 in interest on 290 late payments between October 2002 and December 2004 (27 months). We estimate that the RRB should have paid an additional \$5,000 to \$10,000 in interest on approximately 150 invoices during the same period.¹

The Prompt Payment Act requires Federal agencies to pay interest to vendors whose invoices are paid after the payment due date.² Interest on late payments should be calculated from the day after the payment due date through the payment date at the interest rate in effect on the day after the payment due date.

Our review of a statistical sample of 45 items disclosed that 17 (38%) had been processed using unsupported or incorrect dates, resulting in seven (16%) cases in which the agency underpaid interest or incorrectly determined that no interest was due. The 17 items questioned by the audit exceeded the sample acceptance threshold; accordingly, we cannot conclude that compliance controls are adequate.

¹ This estimate is based on an analysis of FFS data for the stated period. This estimate includes payments that incorrectly omitted interest or included too little interest.

² In general, the payment due date is 30 days after the date a proper invoice is received or goods/services are accepted.

Our review of non-statistical samples of payments to the three vendors submitting a high volume of invoices disclosed similar problems.

Manually Input Milestone Dates Are Frequently Inaccurate

Log and Acceptance dates are manually entered into FFS. Our tests of transactions disclosed that many vendor invoices are processed using incorrect log and acceptance dates.

We questioned 14 of the 45 items in our statistical sample because the log date and/or acceptance date used to process the payment was not supported by the payment voucher. In some cases, the date used was inconsistent with the documented timing of events. For example, we observed invoices processed with log dates after the date that an agency employee had reviewed and initialed the invoice.

The use of inaccurate log and acceptance dates results in incorrect determinations of timeliness and the underpayment of interest.

FFS Not Properly Configured for Prompt Payment Act Processing

Under the Prompt Payment Act, identification of late payments and the related interest calculation should be based on the date a check is issued or an electronic funds transfer is completed. FFS incorrectly determines timeliness and computes interest using the date that a payment voucher is entered into FFS because the RRB has not properly configured the system for Prompt Payment Act processing. As a result, FFS does not identify all late payments and underpays interest in all cases where interest is due.

Interest Rates Are Not Correct

The Treasury Financial Management Service publishes the interest rates to be used in computing interest under the Prompt Payment Act. The RRB did not update FFS for the last two semi-annual changes in interest rate that were effective July 1, 2004, and January 1, 2005 until the error was noted by the Financial Compliance Officer and auditors respectively.

The use of out-of-date interest rates results in incorrect interest computations until the current rate is applied.

Recommendations

We recommend that BFO:

1. implement policies, procedures and controls to ensure that milestone dates manually entered into FFS are accurate and comply with the requirements of the Prompt Payment Act;
2. review FFS settings and make changes as necessary to ensure that timeliness determinations and interest calculations use the correct payment date;
3. implement a control to ensure the timely update of interest rates; and
4. identify payments on which Prompt Payment Act interest was incorrectly omitted or underpaid and make adjustment accordingly.

Management's Response

With respect to recommendation #1, BFO responded that Administrative Circular BSS-14 sets forth the pertinent procedures and requirements. They plan to work with the bureaus and offices to help to ensure that these procedures are fully implemented.

BFO has taken or plans to take, action to implement recommendations #2 and #3. They will consult with the agency's Office of General Counsel on the appropriate way to proceed with recommendation #4.

The full text of management's response is included as Appendix III to this report.

OIG's Comments on Management's Response

We are aware that Administrative Circular BSS -14 addresses some Prompt Payment Act issues; however, the type and number of errors disclosed by this audit indicates that the agency needs to do more than ensure that BSS-14 is fully implemented.

- BSS-14 does not offer guidance in correctly identifying Prompt Payment Act milestone dates.
- BSS-14 does not address the specifics of the payment processing during which BFO personnel identify and input Prompt Payment Act milestone dates.
- BSS-14 does provide for a lengthy review and approval process in which certain invoices are circulated throughout the agency so that user organizations can give manual approval prior to payment. The circular does not explain how to identify the correct Prompt Payment Act milestone dates from among the many receipt and approval dates captured during the review and approval process.

Controls Over Early Payments Need To Be Strengthened

The RRB has not implemented adequate controls to limit the early payment of invoices pursuant to the requirements of the Prompt Payment Act.

The Prompt Payment Act limits the circumstances in which a Federal agency may pay vendor invoices early. A payment is early if it is issued more than seven days prior to the last day on which payment could be made and still be considered timely under the Act. This rule does not apply to payments under \$2,500, to payments to small businesses or if the agency determines that it would be in the best interest of the government to make payment early.

Our review of a statistical sample of 45 items disclosed five that had been paid early based on a comparison of the check date with the payment due date as computed by FFS.³ The supporting documentation for these payments did not show evidence of authorization to pay early or the reason for that decision. The number of items questioned by the audit exceeds the sample acceptance threshold; accordingly, we cannot conclude that compliance controls are adequate.

FFS includes features that would restrict early payments in accordance with the Prompt Payment Act by flagging them for additional approvals. The lack of authorization observed in the exceptions noted above, leads us to question whether the RRB has implemented FFS system controls designed to restrict early payment. In addition, we noted that the agency's quality assurance review process does not include an assessment of compliance with Prompt Payment Act restrictions on early payment.

We have identified instances of non-compliance with early payment restrictions and see no evidence of management or system controls operating to restrict early payments in accordance with the Act. As a result, management has not adequately ensured that early payments have been limited to the conditions and circumstances permitted by the Prompt Payment Act.

Recommendations

We recommend that BFO:

5. revise its policies and procedures to ensure proper determination and authorization of early payments; and
6. review FFS settings and make changes as necessary to implement system features designed to ensure compliance with restrictions on early payments.

³ We did not question any items that were exempt from early payment restrictions based on amount or vendor status.

Management's Response

With respect to recommendation #5, BFO refers the reader to their response to recommendation #1 in which they cite existing procedures published in Administrative Circular BSS-14 and state that they will work to ensure that these procedures are fully implemented. They also state that "if a bureau requests early payment, accounts payable will request written authorization before processing the request."

With respect to recommendation #6, BFO has requested that the Bureau of Information Services reinstate an edit that calls for flagging payments scheduled for 8 or more days prior to the prompt pay date and requiring further authorization before processing can be completed.

The full text of management's response is included as Appendix III to this report.

OIG's Comments on Management's Response

We are aware that Administrative Circular BSS-14 addresses some Prompt Payment Act issues; however, BSS-14 does not discuss the early payment provisions of the Prompt Payment Act nor does it provide guidance to agency officials in determining when it is appropriate to accelerate payment.

Agency Quality Assurance Process Needs Improvement

The RRB has not implemented an effective quality assurance process for Prompt Payment Act compliance. In accordance with the implementing regulations, the RRB performs an annual quality assurance review of payments subject to the Act. That process is not effective because the review process:

- is not designed to disclose incorrect timeliness determinations because it excludes invoices on which no interest was paid;
- does not assess compliance with restrictions on early payments; and
- does not include follow-up to ensure that the weaknesses identified are properly addressed.

Our review of agency quality assurance reports for FYs 2002, 2003 and 2004 disclosed that the agency's Financial Compliance Officer had observed the same deficiencies in milestone dates and the computation of interest that we identified during our audit. However, the internal evaluation did not disclose the impact of those deficiencies on agency compliance because it included only those payments on which interest had been paid.

As a result of weaknesses in the quality assurance process, the study incorrectly concluded that the RRB was in full compliance with the Prompt Payment Act. In addition, the lack of follow-up to ensure implementation of recommendations allowed the deficiencies to persist.

Recommendations

We recommend that BFO review and revise its Prompt Payment Act quality assurance process to:

7. require samples be drawn from the universe of all payments subject to the Prompt Payment Act during the period under review; and
8. include a follow-up process to ensure that compliance issues are fully addressed and corrective action taken as necessary.

Management's Response

BFO has agreed to implement the recommendations. The full text of management's response is included as Appendix III to this report.

Data Integrity Could Be Improved

FFS reports incorrect milestone dates for certain vendors of medical examinations and consultative opinions. Data needs to be accurate in order to be meaningful.

Orders for medical examinations from vendors QTC Medical and Consultative Examinations, Inc. are processed through an automated system that interfaces with FFS. The interface captures receipt and acceptance dates for examinations but passes only the acceptance date to FFS. FFS uses the acceptance date to fill the "Invoice Date," "Log Date," and "Acceptance Date" fields. The use of a single date to fill all these fields diminishes the value of data recorded for these vendors.

Recommendation

We recommend that BFO:

9. review the operational settings of the interface that passes report acceptance data to FFS to determine whether more accurate information can be used to fill FFS table entry for medical vendors.

Management's Response

BFO has agreed to implement the recommendation. The full text of management's response is included as Appendix III to this report.

SAMPLING METHODOLOGY AND RESULTS

Statistical Sampling

We used statistical sampling to assess the effectiveness of controls over compliance with the Prompt Payment Act in the general vendor population.

Audit Objective

The objective of our tests was to assess the adequacy of internal control by testing the results of processing to determine whether:

- decisions were supported by adequate documentation;
- dates used in making Prompt Payment Act determinations were accurate;
- the results of FFS system processing were accurate;
- interest was paid on late payments; and
- early payments had been authorized and met the requirements of the Act.

Scope

We selected the sample from the population of 869 entries in the FFS payment voucher line table with voucher dates during the first quarter of FY 2005. This population excluded payments to three vendors with a high volume of small payments.⁴

Review Methodology

We used statistical acceptance sampling using a 90% confidence level and 5% tolerable error which directed a 45 case sample. The threshold for acceptance was zero errors. Zero errors would permit the auditors to infer with 90% confidence that controls had been operating effectively in at least 95% of processing activity.

Sample Review

For each item in the sample, we:

- obtained and reviewed the paper invoices retained as support for the FFS electronic payment vouchers;
- compared the dates on the payment voucher to milestone dates in FFS;
- made an independent determination of payment timeliness;
- computed interest on those payments identified as late by the audit; and
- looked for evidence of authorization for early payments.

⁴ We tested payments to these three vendors separately. The results of our tests of payment to these vendors, which represent nearly 79% of all payment voucher lines, are presented in Appendix II.

SAMPLING METHODOLOGY AND RESULTS

Statistical Sampling

Results of Review

Our evaluation of 45 randomly selected accounts receivable identified 17 items with exceptions as shown below.

A log and/or acceptance date was not entered into FFS.	3
A milestone date was not supported by agency documentation or was inconsistent with the actual timing of events.	14
A late payment was not identified during FFS payment processing.	6
Interest was due on a late payment, but:	
▪ no interest was paid, or	5
▪ interest was underpaid.	2
A decision to accelerate payment was not documented.	5

Note that some sample items were cited for more than one type of exception.

Audit Conclusion

We identified exceptions exceeding the sample acceptance threshold in all evaluation categories. As a result, we cannot conclude that controls are adequate to ensure compliance with the Prompt Payment Act.

Because of the large number of exceptions, and the systemic nature of the weaknesses underlying the inaccuracies and delays, we did not expand testing to determine whether a larger sample would yield a different result.

SAMPLING METHODOLOGY AND RESULTS

Non-Statistical Sampling

We used non-statistical sampling to assess the effectiveness of controls over compliance with the Prompt Payment Act with respect to three vendors submitting a high volume of invoices. We also used non-statistical methods to determine whether certain claims for payment not subject to the Prompt Payment Act had been handled properly.

Audit Objective

The objective of our non-statistical sampling tests was to determine whether:

- payment to the three major vendors that comprise nearly 79% of all payment voucher lines had been processed in the same manner as the invoices of other vendors with respect to documentation, payment of interest and accelerated payment approval;
- payments not controlled through FFS included any vendors subject to the Prompt Payment Act and, if so, whether they had been processed in compliance with the Act; and
- payments to employees, which are not subject to the Prompt Payment Act, had been processed in compliance with applicable regulations governing timeliness.

Scope

We selected the samples for review from the population of entries in the FFS payment voucher line table with voucher dates during the first quarter of FY 2005.

Review Methodology

We used judgment sampling to select payments for review and evaluated each item in the same manner as for the statistical sample (see Appendix I).

Results of Review

Our non-statistical sampling tests of payment processing for the three vendors submitting a high volume of invoices disclosed the same weaknesses that were identified during statistical sampling of payments to other vendors. Most exceptions were related to cases where milestone dates were not supported by the documentation.

SAMPLING METHODOLOGY AND RESULTS
Non-Statistical Sampling

	Universe	Sample Size	Cases with an Exception
Federal Express	252	22	10
QTC Medical A provider of consultative medical opinions to the RRB's disability program	1,600	12	4
Consultative Examinations, Inc. A provider of consultative medical examinations to the RRB's disability program.	1,330	12	0

We also observed that the FFS payment voucher record fields for invoice, log and acceptance dates are all filled with the date operations personnel had accepted the medical vendors' report.

Our tests of payments not controlled by FFS and claims for payment not subject to the Prompt Payment Act did not disclose any reportable instances of non-compliance.

Audit Conclusion

The results of our non-statistical sampling tests are generally consistent with the results of the statistical sampling tests reported in Appendix I.



UNITED STATES GOVERNMENT

MEMORANDUM

FORM G-115f (1-82)

RAILROAD RETIREMENT BOARD

JUN 10 2005

TO : Henrietta B. Shaw
Assistant Inspector General for Audit

FROM : Kenneth P. Boehne
Chief Financial Officer

SUBJECT: Draft Report – Compliance with Prompt Payment Act

We have reviewed the above draft audit report dated May 27, 2005, and our comments on recommendations are as follows:

***Recommendation 1:** Implement policies, procedures and controls to ensure that milestone dates manually entered into FFS are accurate and comply with the requirements of the Prompt Payment Act.*

The RRB currently has Administrative Circular BSS-4, Procurement of Goods and Services (dated June 10, 2003) in place. The circular summarizes the processes, procedures, and requirements for requesting and completing the procurement of goods and services. BSS-14 also includes the acceptance of goods and services and the Prompt Payment Act requirements. We will work with the bureaus and offices to help to ensure that these procedures are fully implemented.

Target completion date: September 1, 2005.

***Recommendation 2:** Review FFS settings and make changes as necessary to ensure that timeliness determinations and interest calculations use the correct payment date.*

We have implemented this recommendation by reviewing and adjusting the FFS settings to let the system determine the Department of the Treasury disbursement date automatically by leaving the payment date parameter blank prior to each night's processing. The system then uses the current date and adds a predetermined number of "lag" days to it to establish the disbursed date for purposes of computing interest. We have established three as the most practicable

number of lag days after taking into consideration our history of disbursements with Treasury and also weekends and holidays.

Implementation date: May 26, 2005.

Recommendation 3: Implement a control to ensure the timely update of interest rates.

On May 25, 2005, we sent a program request to the Bureau of Information Services (BIS) requesting that it provide an edit in the accounts payable subsystem to alert staff to post the most current interest rate prior to the expiration of the current one.

Target completion date: August 1, 2005.

Recommendation 4: Identify payments on which Prompt Payment Act interest was incorrectly omitted or underpaid and make adjustment accordingly.

We will consult with the Office of General Counsel (OGC) on the appropriate way to proceed with this recommendation. A target completion date will be determined after we receive advice from the OGC.

Recommendation 5: Revise its policies and procedures to ensure proper determination and authorization of early payments.

See recommendation 1. Also, if a bureau requests early payment, accounts payable will request written authorization before processing the request.

Target completion date: September 1, 2005.

Recommendation 6: Review FFS settings and make changes as necessary to implement system features designed to ensure compliance with restrictions on early payments.

On May 25, 2005, we sent a problem report to BIS to reinstate an edit that calls for flagging payments scheduled for 8 or more days prior to the prompt pay date and requiring further authorization before processing can be completed.

Target completion date: September 1, 2005.

Recommendation 7: *Require samples be drawn from the universe of all payments subject to the Prompt Payment Act during the period under review.*

For the next Prompt Payment Act review, the sample will be drawn from the universe of all payments subject to the Prompt Payment Act.

Target completion date: September 1, 2005.

Recommendation 8: *Include a follow-up process to ensure that compliance issues are fully addressed and corrective action taken as necessary.*

A written followup process will be implemented.

Target completion date: September 1, 2005.

Recommendation 9: *Review the operational settings of the interface that passes report acceptance data to FFS to determine whether more accurate information can be used to fill FFS table entry for medical vendors.*

We will work with the Office of Programs and the Bureau of Information Services to review the operational settings of the interface that passes report acceptance data to FFS.

Target completion date: December 31, 2005.